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In the Supreme Court of the United States

October Term, 1932.

No. 192.

DAVID BURNET, Commissioner of Internal Revenue,

Petitioner,

vs.

ALUMINUM GOODS MANUFACTURING COMPANY,

Respondent.

Brief for the Respondent.

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Brief for the Respondent.

REFERENCE TO OFFICIAL REPORT OF THE OPINIONS BELOW.

The findings of fact and opinion of the Board of Tax Appeals (R. 10 to 21) are reported in 22 B. T. A. 1. The opinion of the Circuit Court of Appeals (R. 25-28) was reported in 56 F. (2d) 568.

STATEMENT OF THE CASE.

The summary in the petitioner's brief of the facts, as agreed upon by the parties and accepted by the Board of Tax Appeals (R. 10-15) is accurate; but the following facts omitted in the summary, also must be given consideration:

As stated by the petitioner, the respondent acquired all of the capital stock of Aluminum Sales & Manufacturing Company (hereinafter referred to as the "subsidiary") in 1914 for $29,749.80 and, in addition, at the close of 1917 had owing to it by the subsidiary $47,486.31. As stated by the petitioner, the subsidiary was chiefly engaged in 1917 in liquidating its assets and transacted no business after 1917. The respondent adds that all of the assets and liabilities of the subsidiary were disposed of by the end of 1917, including the transfer to the respondent of its remaining equipment and its good will, which transfer occurred in 1917 (R. 11). The value of the said equipment and good will received by the respondent in 1917 and applied upon its investment in and advances to the subsidiary was $10,684.56 (R. 11). The loss allowed the respondent as a deduction in determining its normal tax for 1917 was computed as follows (R. 12):

Investment in capital stock of subsidiary	$29,749.80	
Advances to subsidiary	47,486.31	
		$77,236.11
Less value of good will and equipment received in 1917 from subsidiary		10,684.56
Total loss claimed and allowed for normal taxes		$66,551.55

The amount of the loss claimed by the respondent in its consolidated return of 1917 for excess profits tax purposes and wholly disallowed by the petitioner was and is $51,861.90, being the difference between the said loss of $66,551.55 and $14,689.65, which was the operating loss of the subsidiary for 1917 included in said consolidated return (R. 12). During the years 1914 to 1917, inclusive, the respondent was the sole owner of all of the capital stock of the subsidiary (R. 12). As stated by the petitioner, sep-

arate tax returns were filed by the respondent and the subsidiary for the years 1914 to 1917, inclusive, except that a consolidated return of the two corporations was filed for excess profits taxes only for the year 1917. Formal certificate of dissolution of the subsidiary was filed with the Secretary of State of the State of New York on February 21, 1918, showing that the Board of Directors of the subsidiary on January 10, 1918, adopted resolutions providing for its dissolution forthwith and that the stockholders of the subsidiary adopted such dissolution resolution on February 11, 1918, (R. 13).

SUMMARY OF ARGUMENT.

I. The loss claimed is admittedly deductible in 1917 if ever, and is admittedly allowable then unless the petitioner's contention is sustained that its allowance be barred because the transaction is "intercompany," and within an affiliated return period. Neither of these conditions exists. The established administrative rules relative to "intercompany" transactions do not apply to a final distribution by a subsidiary, and those relied on by petitioner were adopted after the tax became assessable. If such rules did cover such transactions as that here, they may not be retroactively applied and, as the court below held, "can be sustained only in so far as it [the practice] does not run counter to the provisions of the statute" (R. 27). "Intercompany" is an accounting term having a special meaning not applicable to the transaction at issue. The allowance of the loss here is compatible with the true purpose of consolidated returns. Affiliation here was terminated by a final distribution of assets of the subsidiary.

II. Taxation is a practical matter. Almost all losses and gains upon disposition of property represent a "carrying

forward" of losses and gains economically accrued earlier and that fact does not affect their treatment for taxation when realized. The consolidated invested capital of the respondent and subsidiary may have been more or less than the invested capital of the respondent alone, and it was probably less; but this is not material to deductibility of loss when realized.

III. The petitioner's argument that, if the losses are allowable here, they are non-effective and the deficiency is the same because of the absence of sufficient income on the last day of the year, presupposes the requirement of a separate tax return for such day or a fraction thereof. This supposition is unsound and contrary to the petitioner's long established practice and regulations.

IV. All courts which have passed upon the question, as well as the Board of Tax Appeals, have held consistently with the court below for the position taken by the respondent on similar facts. The petitioner relies upon one case which is claimed to be in conflict with the many consistent cases and another case as in conflict to a limited extent. These two cases are easily distinguishable and have been distinguished. The petitioner distinguishes the case at bar from other consistent cases on the ground that the formal dissolution of the subsidiary's empty shell occurred in the following year, a few weeks after the final distribution of the subsidiary's assets. This circumstance is not only immaterial, but it existed in some of the cases which are in accord with this one. This argument was emphatically rejected by the court below (R. 28). The Board of Tax Appeals, which originally decided against respondent in the case at bar, has accepted the decision of the Circuit Court of Appeals as authoritative, although holding that it is not bound by such decisions; and it has

followed this decision in four recent cases during the pendency of the proceeding in this court. This decision has also been followed and cited with approval by the Circuit Court of Appeals for the Fourth Circuit.

Argument.

I.

THE LOSS IS DEDUCTIBLE; IT IS NOT "INTERCOMPANY" OR WITHIN AN AFFILIATED RETURN PERIOD.

A.

The Loss is Deductible.

The statutes quoted in the petitioner's brief (p. 27) grant the right of deduction of losses in determining net income of 1917 for normal taxes and for excess profits taxes. Losses on sale of stocks are allowable without question and amounts received in liquidation have always been treated as received in sale of the stock. This was first specifically provided in the Revenue Act of 1918 (Act February 24, 1919, c. 18, Title II, 40 Stats. 1058) as follows:

> "Sec. 201 (c)[2]. Amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits."

This provision has been continued in other Revenue Acts; it codifies a legal conclusion and it has been applied retroactively to 1917 by the petitioner in the case at bar (in allowing the loss here for normal taxes) as well as in other cases.

B.

The Loss is Allowable Only in 1917.

This loss was deductible in 1917 only and was not deductible in any earlier or later year. Until 1917 the subsidiary continued in business and had assets, and the possibility of recovery as well as the possible amount thereof was undeterminable *(News Publishing Company vs. Commissioner,* 6 B. T. A. 1257 (1265), affirmed (without discussion of this point) 29 F. (2d) 955 Ct. App. D. C.). Similarly, the deduction of the loss could not be deferred beyond 1917 after the subsidiary had ceased to have assets or operate.

In *DeLoss vs. Commissioner,* 28 F. (2d) 803, 804 (C. C. A. 2), certiorari denied 279 U. S. 840 (affirming 6 B. T. A. 784), a loss upon shares sold in 1921 was denied on the ground that the loss was sustained in 1920 when they became worthless. Similar conclusions were reached in *Russell Wheel & Foundry Company vs. Commissioner,* 3 B. T. A. 1168, and *John W. Mercer vs. Commissioner,* 6 B. T. A. 564.

Moreover, the loss in question has been allowed to the respondent in 1917 for normal tax purposes. As the respondent joins the petitioner in believing that the loss is allowable in 1917, if at all, and has maintained this position consistently, it is difficult to grasp the statement in the footnote at page 18 of petitioner's brief that the respondent cannot complain if the Commissioner's allowance of the deduction for normal tax purposes was erroneous. The respondent has never contended that this allowance of this deduction was erroneous. It appears that petitioner's sole ground for disallowing the loss is the fact that respondent was affiliated with the subsidiary during 1917 and filed a consolidated return for excess profits tax purposes as was required.

C.

This is Not an "Intercompany" Transaction.

Where affiliation existed and the parent corporation sold stock of the subsidiary, the courts have held, on the argument of the petitioner or his predecessors, that the loss or gain should be recognized for tax purposes and that the transaction took place "outside" of the consolidated return period.

Remington Rand, Inc., vs. Commissioner, 33 F. (2d) 77, C. C. A. 2 (certiorari denied 280 U. S. 591).

United Publishers' Corporation vs. Anderson, 42 F. (2d) 781, S. D. N. Y.

Obenchain-Boyer Company vs. Commissioner, 18 B. T. A. 293.

We do not understand that the petitioner challenges this view. It follows that his position rests on the fact that this is a liquidation rather than a sale, despite the similarity between liquidation and sale as recognized in the statutes, as hereinbefore stated. This is claimed to result because the transaction was "intercompany."

The word "intercompany" does not appear in the statutes and the elimination of intercompany transactions is an accounting corollary of the consolidation of returns. The word "intercompany" represents nothing but an accountant's rule to accomplish the proper statutory *purpose of presenting the group as an economic unit* and to prevent the duplication or "pyramiding" of income and losses.. If applied to such a situation as this, the rule would serve only to eliminate the loss entirely so that neither the group nor any of its members is allowed the loss. Thus the application of a proper working rule is proposed to defeat its very purpose, merely because of the language in

which it is couched. A phrase is to be permitted to erase realties. Sometimes tax cases are of necessity decided on purely verbal grounds, but these are cases where the applicable words are contained in the statutes.

It is submitted that "intercompany" transactions, which are to be properly eliminated upon a consolidation of returns, are transactions where the loss by one member of a group is the gain of another. Here the loss to the parent arises from stock originally purchased from outsiders and from loans to the subsidiary which became uncollectible because of losses by the subsidiary in its dealings with third parties. The court below adopted this view (R. 27, 28). Actual losses were suffered by the group and their disallowance is proposed because of the mere fact that the liquidation of the subsidiary—the incident which fixes only the realization of the loss and not its occurrence—can be called "intercompany."

The purpose of Congress in requiring or at times only permitting consolidated returns is to require taxes to be levied according to the true net income and invested capital resulting from and employed in a single business enterprise *(Handy & Harman vs. Burnet,* 284 U. S. 136, 52 Sup. Ct. Rep. 51), and this is recognized by the respondent. In pursuance of the rule, it is proper to eliminate from consideration transactions which arise between two members or parts of the enterprise. The loss here did not arise from the transfer to the parent, at the death of the subsidiary, of equipment and good will of a value of only $10,684.56. This transfer only marked the termination of the possibility of diminution of the loss, and the final determination of the exact amount of the loss, i. e., the realization fact. The loss itself was of the respondent's money invested over a period of years in the stock and advances to the subsidiary. The loss was realized when the worth-

lessness of the investment was determined. *(De Loss vs. Commissioner,* 28 F. (2d) 803, 804, certiorari denied 279 U. S. 840. It seems to be the petitioner's position that this transfer of a negligible amount of salvaged equipment, which has been duly credited against the loss, makes the loss "intercompany" and that, therefore, the whole loss should be eliminated to get at the true income of the whole enterprise. The respondent submits that the contrary is true.

D.

If There is a Contrary Administrative Practice, It Has No Retroactive Effect.

The petitioner asserts that his position here is consistent with administrative practice heretofore (Petitioner's Br. pp. 12, 13). He cites a Solicitor's Opinion and two General Counsel Memoranda. The earliest of these, Solicitor's Opinion 131 C. B. I-1, p. 18, if it properly can be regarded as the position of the Bureau of Internal Revenue, was issued in 1922. The transaction at bar occurred in 1917.

In *Woolford Realty Company vs. Rose,* 286 U. S. 319, this court said:

> [286 U. S. 330] "* * * These provisions were adopted after the liability for the tax of 1927 had accrued, and they can have little bearing upon the meaning to be given to statutes then in force. * * *"

The petitioner also refers to the Bureau's practice ultimately finding expression in Treasury Regulations 75, Art. 37. Treasury Regulations 75 differed from all other regulations in that they are prescribed as binding upon a taxpayer in consideration of the taxpayer availing himself of the *privilege* of making a consolidated return (Revenue Act of 1928, Ch. 852; 45 Stats. 791, §141 (a) and (b); U.

S. C. Title 26, §2141). It has no weight whatever in connection with the determination of 1917 income for war excess profits tax purposes, where a consolidation return was not optional but compulsory.

E.

Affiliation Here Was Termniated.

The courts have repeatedly held that the sale by a parent of stock of its subsidiary, which sale "breaks the affiliation" occurs outside of the affiliated period and gives rise to taxable gain or loss *(Remington Rand, Inc., vs. Commissioner,* 33 F. (2d) 77 (certiorari denied 280 U. S. 591)) and we do not understand that the petitioner holds otherwise. Wherever the question has been presented, courts have held also that a liquidation (final distribution) by a subsidiary has similar results and terminates the affiliation.

Burnet vs. Riggs National Bank, 57 F. (2d) 980.

Wilmington Steamboat Company vs. Sturgess, 52 F. (2d) 210, affirmed 55 F. (2d) 831.

Canal-Commercial National Bank vs. Commissioner, 22 B. T. A. 541.

In none of these cases is there any weight attached to the formal *dissolution* of the subsidiary as the effective act and in all of them it is the final distribution of assets which is considered. It is not respondent's position, as petitioner seems to believe (Petitioner's Br. pp. 10, 11), that the subsidiary's cessation of activities terminated the affiliation or had any other effect. It *is* respondent's position that, upon the subsidiary's divesting itself of all assets and becoming a mere empty shell, the loss actually sustained became ascertained for all time and that the continued existence of the subsidiary for a few weeks pending formal dissolution is immaterial. If it had not been dissolved, it could only have re-entered the financial situation

and the consolidated return by the investment of new money and the starting of another enterprise, which in turn would initiate a new series of transactions and relationships unrelated to the transaction at bar.

The petitioner seems to maintain that the formal act of filing the dissolution paper would constitute all that is necessary to make the loss deductible, for what else can be meant by the statement at page 21 of petitioner's brief—"The fact that this situation might have been easily avoided is not material. The tax laws are replete with instances where apparently formal action would alter the results reached, but the presence of some loopholes in the taxing statutes does not warrant judicial expansion of their number." The respondent does not make the claim that the situation might have been easily avoided or that a formal action would alter the results reached. On the contrary, if filing a dissolution paper is the formal action to which petitioner refers, respondent believes that it is entirely immaterial and has no effect on the transaction.

F.

Invested Capital and Net Income Are Used Consistently.

Petitioner suggests that respondent seeks to have its taxes determined upon the basis of its separate net income at rates determined by the use of consolidated invested capital (Petitioner's Br. p. 22). This is not the result. Respondent does not seek to have its separate net income determined. On the contrary it has consistently dealt with the consolidated net income of the enterprise. It maintains that the consolidated net income was reduced by a bona fide loss which had accrued over a period of years and became legally recognizable upon realization in 1917. *It was not an intercompany loss, since the loss of one mem-*

ber was not reflected as gain to another member of the group, either in this year or at any other time.

The rates of taxation are, of course, determined by the consolidated invested capital for the period of affiliation. The record does not show whether the respondent's separate invested capital would be more or less than the consolidated invested capital. In the nature of things, respondent's separate invested capital would be more, since it would include as part of its assets, its investment in the subsidiary at the full amount thereof until the date of realization of the loss. The consolidation of two corporations to determine the consolidated invested capital involves the substitution of the subsidiary's invested capital for the parent's investment in the subsidiary. The facts of the loss here show that the net worth of the subsidiary in 1917 was considerably less than the parent's investment therein. However, whatever the relationship between the separate invested capital and the consolidated invested capital, respondent maintains that neither separate invested capital nor separate net income is involved in the case.

II.

ALMOST ALL LOSSES AND GAINS UPON THE DISPOSITION OF PROPERTY REPRESENT A "CARRYING FORWARD" OF THE EFFECT OF PRIOR CHANGE IN VALUE.

"Taxation is an intensely practical matter and laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences. * * *"

The Farmers Loan & Trust Company vs. Minnesota, 280 U. S. 204 (212).

Nearly every loss or gain arising from the disposition of property represents an accumulation over several taxing periods of an accruing increase or decrease in value which becomes a gain or loss recognizable for tax purposes upon realization. As this court said in *MacLaughlin vs. Alliance Ins. Co. of Philadelphia*, 286 U. S. 244:

> [286 U. S. 249] "* * * Realization of the gain is the event which calls into operation the taxing act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one. While increase in value of property, not realized as gain by its sale or other disposition, may, in an economic or bookkeeping sense, be deemed an addition to capital in a later period, see Merchants' Loan & Trust Co. vs. Smietanka, 255 U. S. 509, 41 S. Ct. 386, 65 L. Ed. 751, 15 A. L. R. 1305, it is nevertheless a gain from capital investment which, when realized, by conversion into money or other property, constitutes profit which has consistently been regarded as income within the meaning of the Sixteenth Amendment and taxable as such in the period when realized, see Lynch vs. Hornby, 247 U. S. 339, 38 S. Ct. 543, 62 L. Ed. 1149; Merchants' Loan & Trust Co. vs. Smietanka, supra; Eldorado Coal & Mining Co. vs. Mager, 255 U. S. 522, 41 S. Ct. 390, 65 L. Ed. 757; Goodrich vs. Edwards, 255 U. S. 527, 41 S. Ct. 390, 65 L. Ed. 758; Walsh vs. Brewster, 255 U. S. 536, 41 S. Ct. 392, 65 L. Ed. 762; Taft vs. Bowers, 278 U. S. 470, 49 S. Ct. 199, 73 L. Ed. 460, 64 A. L. R. 362; Lucas vs. Alexander, 279 U. S. 573, 49 S. Ct. 426, 73 L. Ed. 851, 61 A. L. R. 906; Willcuts vs. Bunn, 282 U. S. 216, 51 S. Ct. 125, 75 L. Ed. 304."

There is, therefore, no materiality in petitioner's argument (Petitioner's Br. p. 22) that the respondent seeks to carry forward to the year 1917 all the operating losses of the subsidiary in prior years. The same assertion would be true of a loss or gain on any investment in capital stock by any taxpayer, regardless of affiliation questions.

Similarly, the petitioner asserts that the allowance of this loss would be to allow indirectly the carrying forward of a deduction for losses which this court has said may not be accomplished directly, citing *Woolford Realty Company vs. Rose,* 286 U. S. 319, 52 Sup. Ct. Rep. 568, and *Planters' Cotton Oil Company vs. Hopkins,* 286 U. S. 332, 52 Sup. Ct. Rep. 509. These two cases related to the statutory provision for carrying forward the excess of deductions over gross income of one year and deducting the same from the income of a subsequent year *by the same taxpayer.* This statutory provision has nothing to do with the deductibility of a loss on assets at the time it is *realized.* In fact, the two cases just cited are based upon the fundamental theory that each of two or more corporations joining in a consolidated return is none the less a taxpayer and that a corporation does not cease to be such a person by affiliating with another (*Woolford Realty Company vs. Rose,* 286 U. S. 319, 328). This rule is consistent with respondent's fundamental theory on the case at bar that a realized loss suffered by one member of an affiliated group is none the less deductible because it is based upon investment in another member of the group.

The argument is advanced by the petitioner (Petitioner's Br. p. 17) that the parent's gain or loss results solely by a shifting of property and accounts between members of the same affiliated group, which does not affect the financial situation of the enterprise viewed as a whole and that the assets of the group were neither increased nor decreased (Petitioner's Br. p. 13). This is true of any loss or gain recognizable for tax purposes, whether involving an affiliated group or not. Before a loss or gain is recognizable, i. e., realized, the value of the assets nevertheless may have changed. At the moment of realization, there is no change in the values. It is not a true test of

realization of a loss to consider whether a taxpayer's assets are less after the realization than before. The test is whether the assets have been diminished over the period between their acquisition and the termination of their value. The test of whether a certain transaction represents a realization of a gain or loss is not whether the taxpayer had something more or less afterward than before, but whether he had something different or had nothing at all, and whether the value of that different thing, if any, was more or less than the original cost to him of what he previously had.

III.

PETITIONER'S ALTERNATIVE ARGUMENT THAT UPON TERMINATION OF AN AFFILIATION ON THE LAST DAY OF THE YEAR, A SEPARATE RETURN WOULD BE REQUIRED FOR SUCH DAY OR A FRACTION THEREOF IS UNFOUNDED.

As an alternative argument, petitioner asserts that if the court below was correct in deciding that the loss was not intercompany, and that affiliation was terminated by the final distribution, then the loss fell on the parent on the last day of the year and was allowable only on that day, on which there presumably was insufficient income against which to credit the loss, and that, therefore, the allowance of the loss should be noneffective in determining the tax (Petitioner's Br. pp. 23-26). This argument presupposes a requirement for a separate return on the last day of the year; but there is no such requirement, and in fact such supposition is contrary to the petitioner's well-settled practice and regulations. This argument was the basis of petitioner's petition for rehearing in the court

below which, after the filing of briefs, was denied without opinion (R. 30).

The tax to be determined here is that of the respondent, the parent corporation. It is affected, it is true, by the operating gain or loss of the subsidiary during the affiliated period. Nevertheless the respondent remained a separate corporation and taxpayer during said year (*Woolford Realty Company vs. Rose,* 286 U. S. 319), and the petitioner cites no statute or even regulation suggesting that respondent's taxable year should be broken into two parts, of 364 and a fraction days and a fraction of one day, respectively, or that two taxes for respondent for said year should be determined. On the contrary, the statute expressly provides for a single return for the whole year.

Section 13 (a) of the Revenue Act of 1917 (Act Sept. 8, 1916, C. 463 Title I, 39 Stats. 756, Amended Oct. 3, 1917, C. 63 Title I, 40 Stats. 300) provides as to corporations:

> "The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first [followed by proviso for return covering fiscal *year*]."

The war excess profit tax is on the same basis (Sec. 206; set forth in Petitione 's Brief p. 27).

A holding in *Sweets Company of America vs. Commissioner,* 40 F. (2d) 436, C. C. A. 2, on dissimilar facts which might have served as authority for petitioner's position relative to a separate return, was modified by an opposite conclusion of the same court in *American Paper Exports, Inc., vs. Bowers,* 54 F. (2d) 508.

The Board of Tax Appeals (which as hereinafter stated, has receded from its original position in the case at bar

and has cited the decision of the Circuit Court of Appeals here as authoritative in a number of cases) recently decided a case in favor of a taxpayer, on facts indistinguishable from those at bar, to the effect that the loss on the liquidation of the subsidiary was deductible *(Houghton & Dutton Co. vs. Commissioner,* 26 B. T. A. 52). There too the distribution was claimed to have occurred after the close of business on the last day of the year and, when the parties later came before the Board for a determination of the deficiency in the light of the said opinion, the Commissioner similarly asserted that the loss was non-effective. The Board denied this contention in an opinion, promulgated October 31, 1932, 26 B. T. A. ....., from which we quote as follows:

> "On recomputation under Rule 50, the petitioner claims the several deductions in their full amounts from its income for the entire year. Respondent takes the position that the deductions are allowable from petitioner's income only for the period within the year that is outside the period of affiliation, and that as the only period of this kind was the brief interval between the close of business on the last day of the year and the end of the year, during which petitioner had no income, there is nothing from which the several deductions may be taken.
>
> "We think that respondent's position in this respect is erroneous. Deeply rooted in the Federal tax system is the fundamental idea of computation of taxes on an annual basis. *Burnet vs. Sanford & Brooks Co.,* 282 U. S. 359; *Burnet vs. Thompson Oil & Gas Co.,* 283 U. S. 301. Even though affiliated with others, each corporation is still a taxpayer, *(Woolford Realty Co., Inc., vs. Rose,* 286 U. S. 319), and as such is entitled to have its taxes computed on the basis of its taxable year, which requires that it report all income received within the year as yearly, and not daily, income, and carries with it the correlative right to all the statutory deductions growing

out of transactions within the year without regard to the particular day on which they occurred.

"It is argued by respondent that his position here is in accordance with Article 634, Regulations 45, as amended by T. D. 4022 (C. B. VI-1, p. 258) which provides that where two corporations are affiliated at the beginning of the year, but, due to a change in stock ownership or control during the year, affiliation is terminated, a consolidated return shall be filed for the period of affiliation, and a separate return should be filed for each for the remainder of the year. The respondent's theory, if carried into practice, would require the filing of a separate return in cases like this for the fractional part of a day between the close of business on the last day and the end of the year.

"The same provisions appear in subsequent regulations (Art. 634, Reg. 62 and 65), but these later regulations provide further that:

> 'in any case in which the consolidated status is for a period so short as to be negligible, a consolidated return or separate returns for the entire period, as the case may be, may be filed.'

The respondent's position as asserted here is contrary to the quoted provision which has now been long established.

"We are unable to perceive the necessity of a separate return by the parent company for the period within the year following the termination of affiliation. The decisions are uniform in holding that where a corporate taxpayer affiliates during the year with a newly organized corporation which has had no separate existence, a single return containing the income of both during affiliation and the separate income of the one prior to affiliation is all that need be filed. *Automatic Fire Alarm Co.* 13 B. T. A. 1195; *Hutt Contracting Co.*, 17 B. T. A. 818; *Margay Oil Corporation*, 26 B. T. A. 199; *American Paper Ex-*

ports, Inc., vs. Bowers, 54 Fed (2d) 508. The decision in the last cited case is based on the premise that under the circumstances there present, the filing of two returns for the one year would be 'contrary to the general theory of an income tax, which does not allow the splitting of years.' The law being thus established by the decided cases, is there any sound reason why the same rule should not apply where, during the year, affiliation is broken by reason of the factual death of the subsidiary corporation? In such a case there is no period within the year during which the subsidiary had a separate existence, hence there was no period for which it would be required to file a separate return. And the reasons which support the propriety of a single consolidated return by the parent where a newly organized corporation comes into the group, as in the cases cited, are sufficient to permit the filing of a similar return where a subsidiary leaves the group and has no further existence. It is true under both situations that there is a period in which the parent may be said to have a 'separate' existence in one sense of the word. But under what we conceive to be the proper view, the absence of another corporation from which the parent's income must be separated for any part of the year is an important and distinguishing feature. In the situations we are discussing here there is, properly speaking, no period of 'separate' existence for either corporation. During all of the time that both were in being they were affiliated. Under such circumstances we are of the opinion that a consolidated return for the entire year is the only return required and that it should include all the parent's income and deductions for the year."

IV.

THE COURTS AND THE BOARD OF TAX APPEALS ARE IN ACCORD WITH THE DECISION HERE.

The courts which have considered facts similar to the case at bar and also the Board of Tax Appeals have held consistently with the respondent's position here.

The Board of Tax Appeals originally decided a number of cases to the contrary, but subsequent to the decision of the Circuit Court of Appeals of the Second Circuit in *Remington Rand, Inc., vs. Commissioner,* 33 F. (2d) 77 (certiorari denied 280 U. S. 591) (in the case of a sale of subsidiary's stock), the Board has held losses deductible and gains taxable on the sale or liquidation of stocks of subsidiaries. The single exception was the case at bar where the Board held the loss not deductible on the authority of *Utica Knitting Company vs. U. S.,* 68 Ct. Cls. 77, distinguishing the instant case from other cases because of the interval between the liquidating distribution and the formal dissolution. Upon the reversal of the Board by the Circuit Court of Appeals for the Seventh Circuit in the case at bar, the Board has adopted the view of that court as authoritative and has since accordingly decided several cases indistinguishable from the instant case.

The Apartment Corporation vs. Commissioner, 26 B. T. A. 849, (subsidiary allowed to remain in existence until dissolved by proclamation for nonpayment of franchise fees).

The Carey Salt Company vs. Commissioner, 26 B. T. A. 675.

Houghton & Dutton Co. vs. Commissioner, 26 B. T. A. 52, (and supplemental opinion promul-

gated October 31, 1932, 26 B. T. A. .....).

The Prosperity Company, Inc., vs. Commissioner, 27 B. T. A. ..... (Nov. 8, 1932).

The Board of Tax Appeals does not always hold itself bound to follow a decision of the Circuit Court of Appeals.

Riggs National Bank vs. Commissioner, 17 B. T. A. 615 (620).

Mrs. Frank Andrews vs. Commissioner, 26 B. T. A. 642 (649).

Even before the decision of the Circuit Court in the case at bar, the Board had abandoned its original position and allowed a loss under similar circumstances, distinguishing *Utica Knitting Company vs. U. S.*, 68 Ct. Cls. 77, on facts which would be equally effective to distinguish it from the instant case.

H. Liebes & Co. vs. Commissioner, 23 B. T. A. 787.

Other decisions in harmony with the case at bar, involving liquidation and dissolution of subsidiaries are:

Burnet vs. Riggs National Bank, 57 F. (2d) 980 (C. C. A. 4).

American Printing Company vs. U. S., 53 F. (2d) 98 (D. C. Mass.).

Wilmington Steamboat Company vs. Sturgess, 52 F. (2d) 210 (D. C. N. J.), affirmed 55 F. (2d) 831, C. C. A. 3, (without discussion of the point of law).

Charles Ilfeld Company vs. Hernandez, U. S. Dist. Ct. N. Mex., Aug. 19, 1932, [published in full at 323 C. C. H. §9499 (Standard Federal Tax Service of 1932)].

The petitioner relies on *Utica Knitting Company vs. U. S.*, 68 Ct. Cls. 77. To distinguish the case, we only need quote from the opinion therein:

> "It would be an extremely technical evasion of the purpose of the statute [requiring consolidated returns] to hold that a conceded affiliation ceases when the subsidiary ceases to sell and manufacture goods, while at the same time the parent company owns all the stock of the subsidiary, *and the subsidiary continues in business for the purpose of winding up its affairs, turning over its property to the parent, collecting its accounts and paying its debts,* which very debts and accounts arose out of the knitwear business in which both the parent company and the subsidiary were engaged" (Italics ours).

In our case, the subsidiary had already entirely discontinued its business for all purposes, turned over its property to the parent, collected its accounts and paid all its debts except that to the parent.

As heretofore stated, the respondent asserts that its loss was realized upon the final liquidation of the subsidiary's assets and the final distribution of the avails thereof to the parent. The subsidiary's status in the *Utica Knitting Co.* case shown in the above quotation as existing *after* the loss was claimed to have been realized, is the status which *respondent's* subsidiary had *until* and only until the point where the loss was realized.

In *H. Liebes & Co. vs. Commissioner,* 23 B. T. A. 787, (a case similar to the case at bar), the Board of Tax Appeals, after quoting the language above quoted from *Utica Knitting Company vs. U. S.,* 68 Ct. Cls. 77, made the following statement:

> [23 B. T. A. 791] "It is clear from this quotation that the two cases are different. Here the subsidiary corporation had completely gone out of business be-

fore the end of the year and it had no property to turn over to the parent company.

While it may be that at the end of 1921 petitioner and the Ganss Fur Company were technically affiliated because petitioner still owned the stock, a denial of a loss claim on account of that technicality would be to ignore the substance of the situation. Had the petitioner sold the stock in 1921 for a nominal sum—which was all that could have been realized —the case would clearly come within the case *Remington Rand, Inc., vs. Commissioner,* 33 Fed. (2d) 77. The fact that petitioner failed to go out of its way to attempt to make a sale, when in all probability a bona fide sale could not have been effected, should not affect the result. In our opinion loss resulting from worthlessness should be treated no differently than loss resulting from sale and the situation is governed by the *Remington Rand* decision."

The only other case claimed by the petitioner to be inconsistent is *Autosales Corporation vs. Commissioner,* 43 F. (2d) 931, and on this case the petitioner claims a conflict only to a limited extent (Petitioner's Br. in Support of Petition for Certiorari p. 5). The pertinent facts in that case are shown by the opinion to be such that the subsidiary had assets claimed by the parent to be worth $1,348,-557.50, outstanding mortgage trust bonds of a par value of $406,800 (which also indicates the existence of assets) and these assets were apparently leased to the parent corporation, 43 F. (2d) 931, 932, 935.

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed.

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J. GILBERT HARDGROVE,
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